No. 14949.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WILLIAM H. MARTIN, doing business as MARTIN'S AUTO TRIMMING, INC., on behalf of itself and others similarly situated,

Appellant,

vs.

T. C. COLEMAN ANDREWS, as the duly appointed and acting Collector of the Internal Revenue Service of the United States, and ROBERT A. RIDDELL, as Director of the Internal Revenue Service for the Southern District of California,

Appellees.

Appeal From the United States District Court for the Southern District of California, Central Division.

APPELLANT'S REPLY BRIEF.

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ARGUMENT.

I.

Appellants Reply to Appellees Point One:

(*The District Court correctly held that Appellant is prohibited by Section 2201 of 28 U. S. Code from securing any declaratory relief from imposition of excise taxes.*)

Appellees argue that the *Tomlinson* case, 128 F. 2d 808, does not support appellant's contention that there are ex-

ceptions to the Declaratory Judgment Act. Appellees point out that the court in the *Tomlinson* case specifically limited this exception to a situation where a third party was seeking the injunctive relief, not the taxpayer. There are cases where the courts have assumed that a declaratory judgment may be entered involving federal taxes where there are extraordinary and exceptional circumstances.

Murphy v. Graves, 120 F. 2d 243;
Cassale v. Pedrick, 72 Fed. Supp. 848.

Since the *Miller v. Standard Nut* case, 284 U. S. 498, it has been clearly established that notwithstanding the positive prohibition of Section 7421 of Title 26 of the United States Code, that the courts do have jurisdiction to grant injunctive relief against the assessment or collection of federal taxes where there are "extraordinary and exceptional circumstances." The court in *Murphy v. Graves,* indicated that the same principal of law is applicable where the taxpayer seeks a declaratory judgment. There would seem to be no legal basis for making an exception in the one instance notwithstanding the positive prohibition of Section 7421, Title 26 of the U. S. Code, and then refusing to make a similar exception where the facts warrant it under the declaratory judgment statute.

II.

Reply to Appellees Point Two:

(*The District Court correctly held that the appellant is not entitled to an injunction against the proposed assessment of excise taxes under Section 3403 of the 1939 Internal Revenue Code.*)

Appellees seek to distinguish this case from the case of *Miller v. Nut Margarine,* 284 U. S. 498. They argue that in this case "it is evident that there is a legal possibility of the imposition of a valid tax." This argument is predicated on the assumption that the appellants are in truth manufacturers and that custom made-to-order auto seat covers are in fact automobile accessories. Thus appellees conclude that since there is "definitely a legal possibility that a valid tax can be imposed," this is not a proper case for enjoining the proposed assessment of such a tax.

The facts in this case, however, are markedly similar to the facts appearing in *Miller v. Nut Margarine* (*supra*). In that case, as in the instant case, the taxpayers were advised by the agents of the tax collector's office that their product was not taxable; that the taxpayers consequently made no effort to collect the tax; that the enforcement would impose a tax that the taxpayers would be unable to pay, and that such enforced payment would destroy their businesses.

In the *Miller* case, just as in the present case, the tax collector's office had led the taxpayers to believe that the products in question were not taxable and the tax-payers respectively relied upon these assurances.

In the *Miller* case the Supreme Court said:

> "It requires no elaboration of the facts found to show that the enforcement of the act against respondent would be arbitrary and oppressive, would destroy its business, ruin it financially and inflict loss for which it would have no remedy at law."

The court added:

> "It is clear that by reason of the special and extraordinary facts and circumstances, Section 3224, does not apply. The lower courts rightly held respondent entitled to the injunction."

The *Miller* case enunciated a clear distinction under which the exception to Section 3224 would become applicable.

The Supreme Court expressly recognized the distinction of those cases where the illegality was because of error in the amount of tax as distinguished from cases where the product was not covered by the act at all. Thus in the *Miller* case the court declared that since a valid oleomargerine tax could by no legal possibility be assessed against respondent, that the "reasons underlying Section 3224 apply if at all with little force." The Supreme Court then concluded that the lower courts had rightly held that the taxpayers were entitled to the injunction.

Moreover in the present case a number of the taxpayers for whom the action was brought, filed affidavits with the court below to the effect that they did not have the funds to pay the tax in question and that if the defendants would enforce payment, such enforcement would destroy their business. These taxpayers were the following: Richard Lambeth, Eugene L. Lessner, and Junius W. Martin.

The Amended Complaint specifically alleged that many of the plaintiffs would actually be forced to close down and liquidate their businesses if the Collector insisted upon payment of the tax, inasmuch as they do not have the funds to pay such a tax.

In both the Second and Third Causes of action it was likewise alleged that the plaintiffs were not manufacturers but were automobile upholsterers. These facts were not contravened by the appellees on the motion to dismiss in any respect whatsoever. Appellants additionally alleged the following:

(1) That over a period of 20 years the men whose responsibility it was to enforce the tax not only failed to assess such a tax, but throughout this period by letters and oral assurances, led the appellants to believe that the only excise tax that was applicable was a tax on automobile seat covers if they were manufactured by pattern and then placed on the shelves to be sold out of stock as a ready made auto seat cover.

2. That the appellants and the various members of appellants' association relied upon these assurances and did not collect any tax from any of their customers.

3. That the enforcement of such a tax at this time would cause many of the members of the appellant association to be forced to close down and liquidate their businesses if the defendants insisted upon payment, inasmuch as they did not have the funds to pay such a tax.

4. That appellants are not manufacturers but are automobile upholsterers; that the sale of custom made-to-order seat covers by an automobile upholsterer is a sale of labor and materials; that the excise tax in question is a manufacturer's tax and that no one of the appellants were or are manufacturers.

These facts clearly state a cause of action. (*Hirst v. Gentsch,* 133 F. 2d 247; *Midwest v. Brady,* 128 F. 2d 496.)

Appellees insist that despite the decision of Miller v. Nut Margarine, the mere illegality of a tax does not give a right to injunctive relief.

In the recent case of *Morris v. United States,* 229 F. 2d 151, the power of the courts to restrain the enforcement of an illegal tax claim was considered, and there the court in its decision specifically recognized that where a tax is illegal, injunctive relief is appropriate. In arriving at this conclusion the court there said:

> "But it has long been settled that this general prohibition is subject to exceptions in the case of an individual taxpayer against a particular collector where the tax is *clearly illegal,* OR other special circumstances of an unusual character make an appeal to equitable remedies appropriate." (Emphasis added.)

Apparently it is the appellees contention that in a suit to enjoin collection of a tax, whether the tax is applicable need not be considered, but that consideration must be limited to those factors which indicate the presence or absence of exceptional and extraordinary circumstances.

Appellees are intimating that the inapplicability of the tax is not one of the exceptional and extraordinary circumstances referred to by the decisions. Apparently following this line of reasoning the appellees failed to answer appellants contention that custom made auto seat covers are not taxable as accessories.

In *Holland v. Nix,* 214 F. 2d 317, the plaintiff obtained from the District Court a judgment enjoining the tax

collector from enforcing a certain assessment. At the hearing on the Order to Show Cause no controverting evidence was offered by the government. In upholding the lower court's decision the Appellate Court said:

> "As was stated by the Supreme Court in *Miller v. Standard Nut,* 284 U. S. 498, and in subsequent decisions, Section 3653 is general in its terms and should not be construed as abrogating the equitable principles which permit suits to restrain collection where the exaction is illegal (as we think here) or there exist, special and extraordinary circumstances sufficient to bring the case within some acknowledged head of equity jurisdiction. (See also *Shelton v. Gill,* 202 Fed. 2d 503.) It is our opinion that the trial court was correct and the judgment should be affirmed."

In that decision therefore, as well as the case of *Morris v. United States,* the court recognized that illegality, to wit: inapplicability was a ground for injunctive relief as distinguished from the special and extraordinary circumstances referred to by the appellees.

The liberal interpretation of the statute in favor of the taxpayer indicated in *Miller v. Standard Nut,* has been applied in many other cases. Thus the taxpayers have been allowed to enjoin collection of federal taxes in *Shelton v. Gill,* 202 F. 2d 503; *Hirst & Co. v. Gentsch,* 133 F. 2d 247; *Midwest v. Brady,* 128 F. 2d 496; and in other cases cited by appellant.

Other exceptions to the enforcement of this statute have also been found in *Lipke v. Lederer,* 259 U. S. 557; *Regal Drug v. Wardell,* 260 U. S. 386; *Hill v. Wallace,* 259 U. S. 44; *Rickert Rice Mills v. Fontenot,* 297 U. S. 110.

The facts in this case are also analogous to the facts in the case of *Allen v. Regents,* 304 U. S. 439. There the Supreme Court said: "That resort to equity was justified where the tax was one which the taxpayer was not lawfully required to collect."

In *Midwest Haulers v. Brady,* and in *Hirst v. Gentsch, supra,* complaints for equitable relief were upheld based upon allegations that the taxes which the collector was seeking to enforce were *"probably"* not validly assessed. (Emphasis added.)

These cases refute appellees contention that injunctive relief is necessarily limited to situations where there is "no legal possibility" that a valid tax can be imposed.

In a decision handed down on April 24, 1956, the District Court of Virginia held that a plaintiff engaged in an identical method of operation, such as the appellants in this case, was not a manufacturer of accessories within the meaning of the statute but was engaged in merely selling labor. H. H. Keeton, Jr. trading and doing business as *Virginia Auto Top Company v. The United States of America,* No. 2194, and is attached hereto as an addendum to this reply brief.

Whether custom made-to-order seat covers are accessories within the meaning of Section 3403(c) of the Internal Revenue Code of 1939, or are the sale of labor and materials, is now before this court in the case of *Hirasuma v. McKinney.* In that case, of course, the lower court contrary to the decision in the *Keeton* case, held that seat covers were accessories and were subject to excise tax.

In *Johnny & Mack v. United States,* 123 Fed. Supp. 400, the District Court held that the sales of custom made-

to-order seat covers are sales of labor and materials and are not sales as accessories. In that case the government attempted to make the same distinction claimed by the tax collector in this case that custom made-to-order auto seat covers sold to dealers are subject to tax, although similar sales to retail customers were not. The court in the *Johnny and Mack* case disposed of this contention and held that the sales of the seat covers were sales of labor and materials and not sales of seat covers as accessories, regardless as to whether the purchaser is an individual automobile owner or is a new or used car dealer. That the court in the *Johnny and Mack* case rendered a decision that was consistent with the opinion of the excise tax division of the government, is shown in a letter issued by R. J. Bopp, Chief of the Excise Tax Division in Washington. In this letter Mr. Bopp states

> "we agree with the court's conclusion of law that the distinction drawn between sales of seat covers made to order to individual automobile owners and new and used car dealers, is an unwarranted distinction." [Clk. Tr. p. 70.]

Mr. Bopp's letter then went on to assert that he disagreed with the court's view that the sales of seat covers were sales of labor and material. That the Internal Revenue Department, however, has taken an inconsistent position in interpreting an identical method of operation involving the sale of glass by glass shops is shown by a letter issued by Charles J. Valaer, Deputy Commissioner to Paul R. Rioth, set forth in the Clerk's Transcript on page 84.

In that letter the Commissioner of Internal Revenue acknowledged that no distinction would be made in the sale of glass, whether to a retail customer or to a new

or used car dealer. The Commissioner of Internal Revenue therefore has interpreted the sale of glass when immediately installed on an automobile as being a transaction involving the sale of labor and material, and not the sale of an automobile part or accessory. No valid reason exists for determining that a sale of glass when immediately installed is deemed to be a transaction involving the sale of labor, whereas a seat cover made to order and likewise immediately installed, should be held to be the sale of an accessory.

Although Mr. Bopp in his letter mentions that the Internal Revenue Department had previously issued a ruling that custom made seat covers sold to dealers were taxable, such a ruling as is pointed out in the briefs of the *Hirasuma* case was an unpublished ruling and was apparently unknown in California. This is borne out, furthermore, by the fact that at no time prior to August 18, 1952, did the office of the Internal Revenue Department take any steps to enforce payment of the excise tax on custom made-to-order seat covers in the State of California. Conversely as shown by the record in this case the persons whose duty it was to enforce this tax in the State of California made it known that no such tax was applicable.

The Appellant also relies on the case of *United States v. Leslie Salt,* 76 S. Ct. 416, referred to by appellant Hirasuma in his closing brief. There, the court said,

> "administrative practice consistent and generally unchallenged, will not be overturned except for very cogent reasons if the scope of this command is indefinite and doubtful * * * The practice has peculiar weight when it involves a contemporaneous construction of a statute by the men charged with

the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new."

It is respectfully submitted to this Honorable Court that both by reason of the many opinions and interpretations placed upon custom made-to-order seat covers by agents of the appellees to the appellants who were thus led to believe, and did believe, that custom made-to-order seat covers were not taxable, as well as the realistic interpretation made by the court in the *Keeton* case, holding that custom made-to-order seat covers are a sale of labor and not the sale of an accessory that this court should conclude that the tax which the appellees propose to assess against the appellants is an illegal tax, which does not apply to any of the appellants, and that in addition thereto, extraordinary and exceptional circumstances have sufficiently been shown to justify injunctive relief.

It is respectfully submitted that the decision of the District Court dismissing the complaint and in denying injunctive relief should be reversed.

PHILL SILVER,

Attorney for Appellant.

ADDENDUM.

In the United States District Court for the Eastern District of Virginia, Richmond Division.

H. H. Keeton, Jr., trading and doing business as Virginia Auto Top Company v. The United States of America. Civil Action No. 2194.

Opinion.

The plaintiff owns and operates a proprietorship in Richmond, Virginia, under the name of Virginia Auto Top Company. Plaintiff's business, among other things, consists of selling seat cover material to a customer, and then installing or fashioning such material into a seat cover in said customer's automobile. This portion of plaintiff's business is commonly referred to and known as the custom seat cover business. Plaintiff carries no stock of seat covers and only cuts and installs the desired material upon order of the customer. However, plaintiff does carry a varied stock of material. After the customer chooses his desired material from the stock, plaintiff places it on the seats and backrests of the customer's car, marks the material, then removing the material from the car, it is cut to fit. The cut material is then sewn together and fastened to the seats and backrests of the automobile. The price to the customer is fixed by the price of the material plus a mark up for labor and profit.

The Internal Revenue Service of the United States, hereinafter referred to as the defendant, on and after August 8, 1952, assessed an excise tax on all seat covers so made by the plaintiff. This was the manufacturer's tax on automobile accessories sold by the manufacturer under Section 3403 (c), Title 28, U. S. C. A., 1939. Plaintiff paid a total of $640.39 in the period 1952 through the

calendar year 1953, and thereafter filed claim for refund. The refund having been denied plaintiff brings this action.

Plaintiff contends that he is not a manufacturer of automobile accessories within the meaning of Title 28, Section 3403(c), U. S. C. A., of the Internal Revenue Code, 1939. It is his position that he sells seat cover materials and merely performs the labor of installing that material on the automoile of his customer. Hence he is not a manufacturer within the meaning of Section 3403(c), *supra.*

The word "accessory" is the statute has been held to include electric cigarette lighters, seat covers, electric storage batteries, etc. Masterbile Products Corp. v. U. S., 42 Fed. Supp. 294; Crawford Manufacturing Co. v. U. S., 50 Fed. (2d) 280; Universal Battery Co. v. U. S., 281 U. S. 580, at 583-584. In the late case (1955), Masao Hirasuna v. McKinney, 135 Fed. Supp. 897, seat covers were held to be an accessory within the meaning of Section 3403(c). Thus I think it is clear that seat covers, as such, are within the meaning of the word "accessory" in the statute.

However, the crux of the matter in this case resolves itself to the question of whether the type of operation here involved may be construed to be manufacture within the meaning of Section 3403(c), *supra.* The Hirasuna case, *supra,* a Hawaiian case, holds that custom seat covers do come within the meaning of the word "manufacturer" in the statute. In that case the taxpayer ran a business identical in all respects to the business of the plaintiff in the case at bar. The Court held that the seat cover materials were raw materials and that the taxpayer had manufactured the seat covers, *i. e.,* "We find that seat covers were in fact manufactured, for the cars came out of the

shop with seat covers where there were none in the shop when the cars were driven in." (135 Fed. Supp., at 900.)

I am unable to accept the reasoning of the learned judge in this respect. The cases cited *supra* on what an "accessory" is, all deal with tangible objects which are complete units prior to attachment to the automobile. The Internal Revenue Service has always differentiated between manufacture and installation even to the extent of prorating the retail cost, basis of the excise tax, to per cent of cost for the manufactured article and per cent of cost for the labor and installation. They then tax that portion which is manufactured and do not tax that portion which is labor and installation. Thus the accessory, as such, is clearly distinguishable from the labor necessary to make it a functioning part of the car. There are three steps necessary before the accessory becomes a part of the car, *i. e.,* (a) the raw materials, (b) the actual manufacture of the raw materials into a finished useful object, and (c) the installation of this object on to the automobile. If the three-step test is applied here, then the raw materials would be those materials that went into the fabric itself, the bolt of fabric would be the "manufactured" object, *i. e.,* the "accessory", and the cutting and attaching to the automobile of the fabric would be the installation. Actually, in the case at bar plaintiff is concerned only with the last two steps. He acquires the bolt of fabric from the manufacturer and he then applies this fabric, selected by the customer, to the customer's car. This principle is illustrated in the case of Bacon and Van Buskirk Glass Co. v. Luckenbill, 55-1 U. S. T. C., Par. No. 49, 124 (S. D. Ill., 1955), where the plaintiff was in the retail glass business. Plaintiff there would cut from a large plate of glass, glass for a windshield, and then install it in the

customer's car. The Court did not write an opinion but based its holding on the fact that plaintiff did not manufacture the glass, but only cut it to size and installed it. The Bacon and Van Buskirk case, *supra*, was followed in the case of Cotter v. Luckenbill, 55-2 U. S. T. C., Par. No. 9698 (S. D. Ill., 1955).

The United States District Court of Connecticut, in 1926 decided the case of John J. Roche Co. v. Eaton, 14 Fed. (2d) 857. The facts in that case were essentially on all fours with the case at bar except that the plaintiff in the Roche case performed auto repairs in addition to custom slip covers. The Internal Revenue Service has undertaken to distinguish the Roche case from the type of case at bar. However, I think they are undistinguishable and that the conclusions in the Roche case are sound. In the Roche case the Court uses language appropriate to the instant case: "I hold that the dominant aspect of the transaction engaged in by the plaintiff was that of work performed. Materials were, of course, supplied; but the fact that these materials were not manufactured *en masse,* but were fashioned specially in each instance for a specific customer, makes the furnishing of them but an incident of the major transaction."

In view of the foregoing reasoning I hold that the work done by plaintiff does not come within the meaning of Section 3403(c), *supra,* and consequently plaintiff is not a manufacturer of auto accessories within the meaning of the statute.

Judgment for the plaintiff in the sum of $640.39 will be granted upon presentation of appropriate order.

(Sgd.) Sterling Hutcheson
United States District Judge.

April 24, 1956.